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Trendy Green Bonds Offer Little Beyond Feel-Good Vibes For Issuers, Investors

Although green bonds are growing in popularity in the municipal market, the largely unregulated structure may not amount to much more than a marketing tool to drive interest in an issuance.

Municipal green bond issuance totaled $11 billion in 2017, a record high and a 55% increase above 2016, according to the Climate Bonds Initiative (CBI). CBI expects that number to grow to $20 billion in 2018.

Green bonds rarely offer any distinction from traditional muni debt, financing the same projects and often without oversight to ensure the projects are green. While some issuers seek approval from CBI or Sustainalytics, there's no formal regulatory process to ensure the market avoids greenwashing, or applying the green label to projects that may not serve truly sustainable purposes.

As a result, the green label is not always limited to projects that make eco-friendly improvements. For example, a water system financing new pipes but not improving business practices to make them green, or a parking structure that offers battery chargers for electric cars are examples of projects not delivering on green benefits, an underwriter and portfolio manager told Debtwire.

But no investment is more fundamentally focused on improving people's lives than the municipal bonds. The explicit purpose of the $3.8 trillion municipal market is to function for the public good, with most issuances financing investment in our nation's infrastructure: building schools, hospitals, roads, public transportation, and utilities, including public power, water and sewer systems.

So why do municipal issuers bother with the green bond label? Ultimately, it's a marketing technique, used to generate interest in a new issuance and to attract interest from millennials or other investors searching for green and sustainable investments, according to market sources— an underwriter, portfolio manager and issuer—specializing in green bonds. More demand should, in theory, drive the cost of borrowing down, resulting in cost savings for the issuer. However, significant cost benefits as a result of issuing green bonds have not materialized, these sources said.

New York's Metropolitan Transportation Authority (MTA) is one issuer that's revised their strategy to favor green bonds. MTA began issuing green bonds in 2016, and in an interview with Debtwire, disclosed that they've determined that going forward, the majority of its debt will be issued as green bonds, in line with its function as a mass transit operator. Unlike some green bond issuers, MTA does pursue third-party certification for its issuances, verifying their "green-ness."

But the security structure—what pays off the debt—is no different than when MTA comes to market with traditional revenue bonds, supported by a pledge of transportation revenue, or sales tax-backed bonds, and that's the same for any issuer that decides to embrace a green strategy.

Savvy green bond investors should do their homework and learn about what they're purchasing to make sure there is something beyond the label.

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By Maria Amante

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Maria Amante is a reporter for Debtwire covering stressed credits in New York, California, Alaska, higher education and continuing care retirement community sectors. She can be reached at Maria.Amante@acuris.com.

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